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C O N F I D E N T I A L SECTION 01 OF 02 BAGHDAD 000359

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E.O. 12958: DECL: 02/06/2016
TAGS: [ECON](#) [ENRG](#) [EPET](#) [ETRD](#) [MOPS](#) [MARR](#) [PGOV](#) [PREL](#) [PTER](#)
TU, IZ
SUBJECT: CHALABI BULLISH ON FUEL PRICING, DOWNCAST ON
EXPORT POTENTIAL

REF: A. BAGHDAD 219
[1](#)B. BAGHDAD 241

Classified By: Ambassador Zalmay Khalilzad for reasons 1.4 (b) and (d).

[1](#)1. (C/REL GBR AUS) SUMMARY: Deputy Prime Minister Chalabi told the Ambassador on February 5 that a letter issued by PM Ja'fari empowering Chalabi to oversee fuel supplies to Baghdad was wholly inadequate to the task of restoring domestic refined product supplies and exports. The Ambassador followed up February 5 with the PM to secure a broader mandate for Chalabi. Chalabi appeared heartened by the market response to higher fuel prices mandated by the IMF. He reported that Baghdad demand for gasoline is down sharply, putting total domestic consumption within range of domestic refining capacity plus a reduced level of imports. Negative news centered on ramifications of a February 2 explosion and fire at the Kirkuk oil processing (desulfurization) facility. Initial estimates indicate that complete repair work will take up to a year -- a severe blow to hopes of restoring northern oil exports. Finally, Chalabi briefly touched upon oil arrears negotiations with the Turkish government, noting that he had spoken to the Turkish Ambassador about clearing the arrears and putting the refined products trade on sounder footing. In response, the Ambassador offered broad-based assistance, including contacts with suppliers to speed up delivery of essential repair parts; intervention with the PM and other senior personnel; and increased cooperation to ensure completion of vital oil and electricity sector projects. END SUMMARY.

Chalabi Lacks Authority as Energy Czar

[1](#)2. (C/REL GBR AUS) DPM Chalabi told the Ambassador on February 4 that, although he had received a letter from the PM empowering him to oversee the activities of the Ministries of Oil and Electricity, the letter in fact does little. (COMMENT: The letter only vaguely defined his authority and referred only to fuel supplies for Baghdad. In addition to ignoring consumption needs of the country at large, it did not touch upon the need to bring export capacity back on line. END COMMENT.) Chalabi ascribed the poor follow-through to bad staffing rather than any disagreement within the GOI. The Ambassador promised to follow up with the PM to ensure that the powers as promised (reftel A) are authorized ASAP.

[1](#)3. (C/REL GBR AUS) Taking immediate steps to resolve the situation, on February 5 the Ambassador delivered to PM

Ja'fari more comprehensive language to include in the letter empowering Chalabi as "Energy Czar." Ja'fari said he is receptive to the Ambassador's argument, promising to sign a modified version of the letter on February 6.

Making the Most of Consumption Reduction

¶4. (C/REL GBR AUS) Chalabi told the Ambassador that demand in Baghdad had dropped to about 4 million liters of fuel per day from a high of about 8.5-10 million liters (24 million liters countrywide) before the December 18 price increases that mandated by the IMF Stand-By Arrangement (SBA). He put national consumption following the price increase at about 20 million liters per day, of which Iraq could produce 13 million liters with reasonable certainty (2.5 million liters from Daura refinery, 3 million liters from Basrah, and 8.5 million liters from Bayji). Iraq thus requires imports, he added, of some 6 million liters per day -- a goal possible to meet under the 2006 monthly import limit of \$150 million (NOTE: This figure allows for a monthly payment of approximately \$50 million on Iraq's arrears, on top of the \$150 million. END NOTE.) Although he called the 13 million liters of domestic production "sustainable," Chalabi readily acknowledged that meeting this target required Bayji refinery remain on-line and accessible. "They are 60% of our capacity," Chalabi said, "and right now we are getting nothing."

Impact of the Kirkuk Processing Plant Explosion

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¶5. (C/REL GBR AUS) Iraq Reconstruction Management Office (IRMO) Deputy Director MG Heine then briefed DPM Chalabi on the status of the year-old Kirkuk oil processing facility since a February 2 explosion and fire there. Although the exact cause of the blast is not yet known (the fire has not yet been extinguished), MG Heine reported that the facility could, by our first estimate, be out of commission for up to a year. Many of the parts required for repair are special order and not readily available, he said. MG Heine added that IRMO hopes to have a more complete assessment o/a February 9, and then will be better able to judge whether the facility may be brought back in line in stages. The old facility, currently processing 150,000 BPD, could be brought up to a rate of 500,000 BPD over the course of the next month. With 350,000 BPD going to feed the Bayji refinery, the GOI would be able to export a maximum of 150,000 BPD from the north once the 40" pipeline is repaired.

¶6. (C/REL GBR AUS) Chalabi was visibly distressed, saying that this news "knocks a big hole in my expectation." He stated that Iraq has to export no less than 1.57 million BPD in order to meet IMF budget expectations, leaving aside domestic refining needs. (NOTE: The actual IMF projection is somewhat higher than 1.57M BPD but is pegged at a lower price per barrel than currently obtained. END NOTE.) Chalabi said that his goal is to reach 3 million BPD by the end of 2006 -- a goal that, in theory, is achievable with improved security and projects due to come on-line this year. He expects a production increase of 200-300,000 BPD from 60 USG-financed well workovers in the south, due to begin in April and be completed in six months. Chalabi said that the explosive charges necessary for this project had arrived in Iraq on January 18. Another 230 wells would benefit from workovers, he added, but would require additional gas oil separation (GOSP) capacity before the new oil produced could be processed. Chalabi also asked for U.S. help to procure pipeline valves, stressing that these are essential to installing every 10 kilometers to avoid draining a damaged pipeline before effecting repairs (Comment: One of MoO's initial objections to repairing the currently down 22"

product line was that they could not afford to waste the fuel - the line would inevitably be hit again as soon as it filled up, spilling thousands of liters of irreplaceable product. End Comment).

Turkish Arrears -- Initial Steps

¶7. (C/REL GBR AUS) Chalabi said that he had spoken to the Turkish Ambassador to Iraq about Iraq's outstanding debt to Turkish fuel suppliers and finding a way forward for future deliveries. According to Chalabi, Iraq had paid the Turks \$150 million in January; another \$700 million is still owed, which Iraq proposes to pay over the next year. He said he stressed that Iraq's total monthly expenditure on fuel could not exceed \$200 million/month. The Turks favor a six month repayment schedule, Chalabi said, adding that "we'll work this out."

Offer of USG Assistance

¶8. (C/REL GBR AUS) The Ambassador stressed that the U.S. is eager to work with Chalabi as an effective GOI interlocutor to achieve our shared goals in the energy sector. He offered personnel to assist in the DPM's office; assistance urging suppliers to make a priority delivery of parts for repairs in Kirkuk; intervention with the Prime Minister and other senior GOI officials when necessary; and increased cooperation/intervention to ensure timely completion of electricity and oil sector projects.
KHALILZAD